STATE OF UTAH INSURANCE DEPARTMENT

REPORT OF EXAMINATION

OF

MOLINA HEALTHCARE OF UTAH, INC.
dba AMERICAN FAMILY CARE OF UTAH, INC.
OF
MIDVALE, UTAH

AS OF

DECEMBER 31, 2004

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January 24, 2005

Honorable D. Kent Michie, Commissioner
State of Utah Insurance Department
State Office Building, Room 3110
Salt Lake City, Utah 84114-6901

In accordance with your instructions and in compliance with Utah Code Annotated (U.C.A.) Title 31A, an examination of the financial condition and business affairs of

MOLINA HEALTHCARE OF UTAH, INC.
dba American Family Care of Utah, Inc.
of
Midvale, Utah

hereinafter referred to as (the Organization), was conducted as of December 31, 2004.

SCOPE OF EXAMINATION

Period Covered by Examination

The Utah Insurance Department's (Department) last financial examination of the Organization was conducted as of December 31, 2001. The current examination covers the period from January 1, 2002, through December 31, 2004, including any material transactions and/or events occurring subsequent to the examination date noted during the course of the examination.

Examination Procedure Employed

This examination was conducted under the association plan of the National Association of Insurance Commissioners (NAIC). The examination was conducted in accordance with the NAIC Financial Condition Examiners Handbook, while also incorporating top-down, risk-focused examination techniques included in the current draft version on Risk Focused Examinations of the NAIC Financial Condition Examiners Handbook.

As part of the Risk-Focused Examination process, examiners spent the first portion of the examination reviewing information about the Organization's structure, business approach, and control environment to develop an examination approach that would most closely fit the Organization. It was determined that a functional activity approach would be most appropriate. Based upon the review, the following functional areas were developed for the examination approach: Management, Investments, Policyholder Services, Premiums, Losses, and Payables.

Examiners then determined the applicable risks in each of the functional areas and used information gathered from the Organization, from interviews conducted with the senior management team, and from work performed by the external auditor to evaluate how these risks have been addressed. In some cases, examiners determined the work conducted by the external

auditor was sufficient to address and mitigate the identified risk area. In these cases, no additional testing was conducted, while in other areas the identified risk was either not addressed or not sufficiently addressed and additional testing was warranted.

The examiners relied upon an analysis of indicated loss and loss adjustment reserves report prepared by the Department's contracted actuarial consulting firm, Taylor-Walker & Associates, Inc. The examiners tested the completeness of the records provided to the firm, and the accuracy of the underlying data used to establish reserve amounts.

A letter of representation certifying that management has disclosed all significant matters and records was obtained from management and is included in the examination working papers.

Status of Adverse Findings, Material Changes in the Financial Statements, and Other Significant Regulatory Information Disclosed in the Previous Examination

Adverse findings noted in the prior report of examination were addressed by the Organization or were identified as repeat exceptions in this report.

HISTORY

General

The Organization was incorporated under the laws of the state of Utah on May 27, 1994, as a wholly owned subsidiary of Molina Medical Centers. On May 1, 1996, the Utah Insurance Department issued the Organization a Certificate of Authority to conduct business as a health maintenance organization (HMO).

Effective January 1, 2000, 100% of the Organization's stock was transferred from Molina Medical Centers to American Family Care, Inc., a holding company now known as Molina Healthcare, Inc. The ownership of Molina Healthcare, Inc. was identical to the prior ownership of Molina Medical Centers; therefore, no change of control took place as a result of the reorganization. The Organization amended its articles of incorporation on February 25, 2000, and the name of the corporation was changed from American Family Care of Utah, Inc. to Molina Healthcare of Utah, Inc.

The Organization's bylaws, articles of incorporation and minutes of the board of directors meetings and sole shareholder meetings held during the period covered by this examination were reviewed. There were no amendments made to the bylaws or articles of incorporation during the examination period.

Capital Stock

As of December 31, 2004, the number of shares of common stock authorized by the Organization was 100,000 at a par value of $1.00 each. The number of shares issued and

outstanding was 100,000. Molina Healthcare, Inc. owned 100% of the outstanding shares of common stock.

Dividends to Policyholders

During the period under examination the Board of Directors did not declare and the Organization did not pay stockholder dividends.

Management

Directors serving as of December 31, 2004, were as follows:

Name	Principal Occupation
Joseph M. Molina, M.D. Long Beach, California	President and Chief Executive Officer Molina Healthcare, Inc.
George S. Goldstein, Ph.D. Long Beach, California	Executive Vice President Molina Healthcare, Inc.
George Kirk Olsen Midvale, Utah	President/Chief Executive Officer Molina Healthcare of Utah, Inc.
Clayton S. Wilde, M.D. Salt Lake City, Utah	Physician
Suzanne C. Ferry Salt Lake City, Utah	Legislative Executive Consulting Owner
Lorin C. Barker Salt Lake City, Utah	Attorney at Law Kirton & McConkie
Charles A. Coonradt Park City, Utah	President/Owner The Game of Work, Inc.

The following directors constituted the membership of the Organization's committees as of December 31, 2004:

Audit Committee Members

Lorin C. Barker, Chairperson
Charles A. Coonradt
Suzanne C. Ferry
Clayton S. Wilde, M.D.

Officers elected by the board of directors and serving as of December 31, 2004 are as follows:

Principal Officer	Office
George Kirk Olsen	President/Chief Executive Officer
Mark L. Andrews	Secretary
Paul J. Muench	Treasurer

As of December 31, 2004, the Audit committee did not keep a record of minutes of its proceedings as required by Article II.G.2 of the Corporate Bylaws of the Organization. Without a record of the proceedings of the Audit committee the examination could not objectively determine that the committee maintains adequate overview of the Organization audit activities, systems, and staff or of the outside auditors. Additionally, the examination could not determine that the audit committee provided adequate advise to the board on the adequacy of fiscal control as required per U.C.A. §31A-5-412 as referenced by U.C.A. §31A-8-215.

Conflict of Interest Procedure

According to Article II.I of the Organization's by-laws, "the Board of directors shall require officers and directors of the Corporation to complete annual disclosure statements regarding conflicts of interest and "party-in-interest" transactions." The Organization effectively complied with the requirement with two exceptions for disclosures, which were identified as missing and therefore could not be reviewed. These disclosures were the 2002 disclosure of John C. Molina, Vice President and the 2004 disclosure of Clayton Wilde, Director.

Corporate Records

In general, the stockholder and board of directors meeting minutes indicated the board and its committees adequately approved and supported the Organization's transactions and events. In accordance with U.C.A. §31A-2-204(8), the Organization promptly furnished a copy of the prior examination report to each member of the board on August 6, 2003.

Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance

Effective March 3, 2005, the Organization's affiliate Molina Advantage Inc., a Utah Corporation and licensed third party administrator (TPA), merged into Molina HealthCare of Utah, Inc., the surviving corporation. The Commissioner exempted the Organization from the requirements of U.C.A. §31A-16-103 pursuant to U.C.A. §31A-16-103(13), after Utah Administrative Code (U.A.C.) Rule R590-232 became effective. HMOs are now authorized to provide services as a TPA of health care benefits.

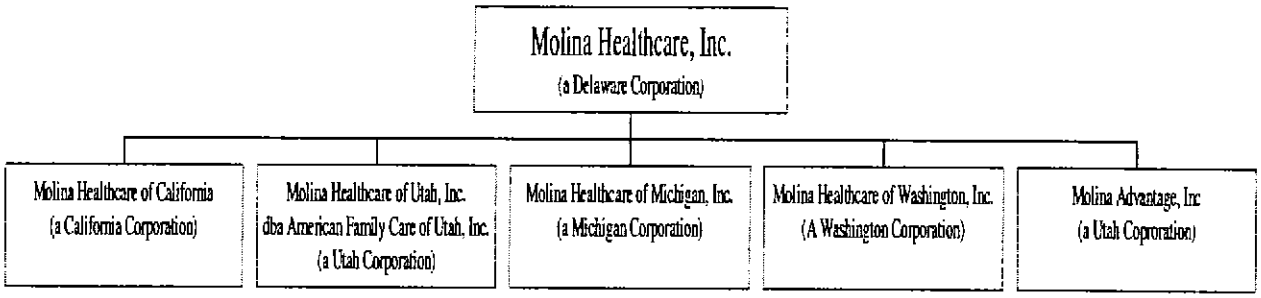
All 100 shares of issued and outstanding common stock of Molina Advantage Inc. ceased to exist. Each share was replaced with one-tenth (1/10th) of a share of common stock of the Organization.

Surplus Debentures

No debentures were issued or retired during the examination period and none were outstanding as of December 31, 2004.

AFFILIATED COMPANIES

The Organization is wholly owned and controlled by Molina Healthcare, Inc. An organizational chart illustrating the holding company system follows:



Transactions with Affiliates

The Organization has a Services Agreement with Molina Healthcare, Inc., effective March 1, 2000, pursuant to which the parent provides services relative to (a) human resources, including consultation, administration and payroll, (b) information systems, including problem resolution, server service and information systems, (c) accounts payable, (d) legal advice, (e) financial consulting, (f) claims consulting, (g) medical consulting, and (h) strategic management consulting.

Effective January 1, 2001, pursuant to the Services Agreement by and between the Organization and Molina Advantage, Inc., an affiliate operating as a third party administrator, the Organization provides personnel, information systems and management services to Molina Advantage, Inc. Molina Advantage, Inc. merged into the Organization on March 3, 2005. (See the Acquisitions, Mergers, Disposals, Dissolutions, and Purchases or Sales through Reinsurance section of this report.)

The Organization files a consolidated federal income tax return with its parent, Molina Healthcare, Inc. The parent collects the amount of taxes or benefits determined as if the subsidiary filed a separate return.

FIDELITY BOND AND OTHER INSURANCE

The amount of fidelity insurance coverage recommended by the NAIC for an insurer of the Organization's size is between $600,000 and $700,000. The Organization had fidelity coverage with a single loss limit of $2,000,000.

The Organization was also a named insured under policies providing property and liability coverage.

PENSION, STOCK OWNERSHIP AND INSURANCE PLANS

As of the examination date, the Organization offered a 401K defined contribution plan to eligible employees, which allowed participants to contribute from 1% to 25% of pretax annual compensation. The Organization makes a discretionary matching contribution equal to 100% of the first 4% of participant contributions. The Organization provided medical, dental, vision, short term disability and life insurance to its eligible employees and their dependents. A deferred compensation plan was also provided to management and key personnel.

STATUTORY DEPOSITS

Pursuant to U.C.A. §31A-8-211(1), the Organization is required to maintain a statutory deposit equal to $550,000. Wells Fargo Bank N.A., under a tri-party agreement with the Department and the Organization, held a U.S. Treasury Note with a statement value of $575,528 and a market value of $574,103.

INSURANCE PRODUCTS AND RELATED PRACTICES

Policy Forms and Underwriting

Pursuant to agreements with the State of Utah Department of Health, the Organization provides two lines of coverage, Medicaid and the Children's Health Insurance Plan (CHIP).

The Medicaid and CHIP programs are administered by the State of Utah Department of Health, and the federal Centers for Medicare and Medicaid Services (CMS) in the United States Department of Health and Human Services monitor the programs. CMS establishes requirements for service delivery, quality, funding, and eligibility standards for the Medicaid program. Within broad Federal guidelines, the Department of Health determines the design of the CHIP program, its eligibility groups, benefit packages, payment levels for coverage, and administrative and operating procedures. The Organization does not provide dental or mental health services.

The Medicaid agreement provides reimbursement to the Organization for claims and provides additional funds to cover administrative expenses. The Organization retains no risk under this arrangement.

The CHIP agreement provides premium on a per member per month basis. The Organization's risk retention limit is $50,000 and 20% of the costs exceeding $50,000 per enrollee.

Territory and Plan of Operation

The Organization is authorized to provide health care services as a health maintenance organization (HMO) only in the state of Utah as of December 31, 2004.

The Organization's marketing system is limited to the CHIP program. Under restrictive provisions of the Medicaid and CHIP program contracts, marketing its Medicaid program is prohibited and marketing the CHIP program is limited to only those efforts approved by the Utah Department of Health.

Advertising and Sales Material

The Organization limits marketing to approved brochures available at the offices of CHIP providers.

Treatment of Policyholders

The Organization had a written complaint and grievance procedure in place to maintain control over member complaints and appeals. During the course of the examination there were no complaints filed with the Department.

All claims that are appealed are adjudicated through the fair hearing process. A Utah State Department of Health administrative law judge hears such appeals.

REINSURANCE

Ceded/Assumed

During the prior examination period the Organization ended its reinsurance program and shifted to a risk retention limit program for it's Medicaid and Chips programs. The State of Utah assumed all risk greater than $50,000. As of July 1, 2002, when the Organization went to a non-risk plus administrative cost program, the Organization no longer assumed risk for the Medicaid program.

During the period covered by the examination, the Organization neither ceded nor assumed reinsurance.

ACCOUNTS AND RECORDS

The Organization's accounting systems were maintained on a local area network. Subsidiary records were maintained in commercial software applications on stand-alone personal computers.

Data from these sources, along with the services of an independent accounting and consulting corporation, were used to prepare annual and quarterly statements, schedules and exhibits, and other financial statements. The same firm also maintained the general ledger.

The financial accounting functions were performed both at the Organizations' office in Midvale and at the Organization's parent office in Long Beach, California. The premium processing was centralized, collected, processed and accounted for in the Midvale office.

An independent certified public accounting firm audited the Organization's records during the period covered by this examination. Audit reports generated by the auditors for the years 2002 through 2004 were made available for the examiner's use.

The Organization's general ledger was maintained on an accrual basis. The examiner footed the Organization's general ledger trial balance and reconciled it to the balance sheet and income statement expenses and surplus contained in the December 31, 2004 annual statement. Individual financial statement accounts for the years covered in the examination period were reviewed and reconciled as deemed necessary.

Item eleven of the general section of the Annual Statement Instructions promulgated by the NAIC states, "If the report does not contain the information asked for in the blanks or is not prepared in accordance with these instructions, it will not be considered filed." In addition, U.C.A. §31A-2-202(6) requires that "All information submitted to the commissioner shall be accurate and complete."

1. Schedule T in the Annual Statement for the year ending December 31, 2004 incorrectly reported premium collected for the state of Utah as collected in the country

of Canada. This was not in compliance with the NAIC Annual Statement Instructions. This error was corrected in the subsequent Quarterly Statements in 2006.

FINANCIAL STATEMENTS

The Organization's financial condition as of December 31, 2004, and the results of its operations during the twelve months then ended, as determined by examination, are reported in the following financial statements:

Balance Sheet as of December 31, 2004
Statement of Revenue and Expenses
For the Year Ended December 31, 2004
Capital and Surplus – January 1, 2002 through December 31, 2004

The accompanying notes to financial statements are an integral part of these statements.

Molina Healthcare of Utah
Balance Sheet
As of December 31, 2004

Bonds	$ 575,528	
Cash and short-term investments	7,143,873	
Investment income due and accrued	2,336	
Uncollected premiums and agents' balances in the course of collection	28,807,455	(1)(2)
Net deferred tax asset	98,517	
Electronic data processing equipment and software	18,812	
Receivables from parent, subsidiaries and affiliates	131,227	
Total assets	36,777,748	
LIABILITIES, CAPITAL AND SURPLUS		
Claims unpaid	19,873,582	
Unpaid claims adjustment expenses	404,266	
General expenses due or accrued	393,098	
Current federal and foreign income tax payable and interest thereon	946,238	
Amounts due to parent, subsidiaries and affiliates	8,642,060	
Total liabilities	30,259,244	
Common capital stock	100,000	
Gross paid in and contributed surplus	6,398,584	
Unassigned funds (surplus)	19,920	(1)(2)
Total capital and surplus	6,518,504	
Total liabilities, capital and surplus	$ 36,777,748	

Molina Healthcare of Utah
Statement of Revenue and Expenses
For the Year Ended December 31, 2004

		Notes
Net premium income	$ 6,663,549	
Aggregate write-ins for other health care related revenues	93,910,022	(1)
Total revenues	100,573,571	
Hospital/medical benefits	328,853	
Other professional services: Compensation to non-physician providers	750,050	
Outside referrals	2,840,507	
Prescription drugs	798,930	
Aggregate write-ins for other hospital and medical	84,088,704	
Less: Net reinsurance recoveries	(122,436)	
Total hospital and medical	88,929,480	
Claims adjustment expenses	2,170,459	
General administrative expenses	7,125,180	
Total underwriting deductions	98.225,119	
Net underwriting gain or (loss)	2,348,452	
Net investment income earned	(276,345)	
Net realized capital gains or (losses)	0	
Net investment gains or (losses)	(276,345)	
Net income or (loss) before federal income taxes	2,072,107	
Federal and foreign income taxes incurred	833,594	
Net income (loss)	$ 1,238,513	

Molina Healthcare of Utah
Capital and Surplus
January 1, 2002 through December 31, 2004

	2002	2003	2004	Notes
Capital and surplus, December 31, previous year	$ 3,361,207	$ 4,918,084	$ 5,358,237	
Net Income or (loss)	(31,153)	431,112	1,238,513	(1)
Change in net deferred income tax	99,843	34,232	(12,871)	
Change in nonadmitted assets	7,726	(69,518)	91,750	
Surplus adjustments: Paid in	1,400,000			
Aggregate write-ins for gains or (losses) in surplus:				
Change in State DTA & DTL	3,934	44,327	(16,118)	
Audit Changes from Prior Year	76,527			
Examination premium adjustment from Prior Year			(141,007)	(2)
Net change in capital and surplus for the year	1,556,877	440,153	1,160,267	
Capital and surplus, December 31, current year	$ 4,918,084	$ 5,358,237	$ 6,518,504	

Uncollected premiums $28,807,455

The Organization reported an asset for uncollected premiums and agents' balances in the course of collection of $29,254,157. The examination decreased the asset by $446,702,which is based upon two examination findings.

(1) The asset was decreased to reflect the reduction of administrative fees receivable, under provisions of the Organization's Medicaid program contract, which are based upon estimated claim payments during the period subsequent to the examination date. The actual claim payments were less than the original estimate, reducing the receivable by $305,695.

(2) The Organization reported a receivable for expected recoveries for Medicaid claim payments withheld by the Department of Health. The Organization and the Department of Health subsequently reached a stipulated agreement that reduced the expected recovery by $141,007.

CAPITAL AND SURPLUS

The Organization's capital and surplus was determined to be $446,702 less than reported in the Organization's annual statement as of December 31, 2004. The following schedule identifies the examination changes:

Description	Annual Statement	Per Examination	Surplus Increase (Decrease)	Notes
Uncollected premiums	$ 29,254,157	$ 28,807,455	$ (446,702)	(1)(2)
Total changes			(446,702)	
Capital and surplus per Organization			6,965,206	
Capital and surplus per Examination			$ 6,518,504	

U.C.A. §31A-8-209(1) requires the Organization to maintain a minimum capital in the amount of $100,000. As defined by U.C.A. §31A-17-601, the Organization reported total adjusted capital of $6,965,206 and an authorized control level risk-based capital (RBC) requirement of $1,362,185 as of December 31, 2004.

The examination determined total adjusted capital to be $6,518,504 as of December 31, 2004. The examination accepted the Organization's authorized control level RBC because adjustments made for examination purposes would not have a significant effect on the RBC requirement.

SUMMARY

Items of significance contained in this report are summarized below:

1. The Organization reported an asset for uncollected premiums and agents' balances in the course of collection of $29,254,157. The asset disclosed on the Balance Sheet contained in this examination report was $28,807,455. (NOTES TO FINANCIAL STATEMENTS)

2. Pursuant to U.C.A. §31A-8-209(1) the Organization is required to maintain minimum capital in the amount of $100,000. The Organization reported total adjusted capital of $6,965,206 and an authorized control level risk-based capital (RBC) requirement of $1,362,185 as of December 31, 2004. The examination determined total adjusted capital to be $6,518,504 as of December 31, 2004. (CAPITAL AND SURPLUS)

CONCLUSION

Assistance and cooperation extended during the course of the examination by officers, employees, and representatives of the Organization are acknowledged. Colette Reddoor, CFE, Assistant Chief Examiner supervised the examination.

Respectfully submitted,

Donald R. Catmull, CFE
Examiner-in-Charge, representing the
Utah Insurance Department